

Tax Treatment & Rules for Fringe Benefits

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Overview

- Why are we here?
- Accountable Plans
- Exclusions
- Fringe benefit analysis
- Common fringe benefits
- Questions

Why are we here?

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Fringe Benefits for Exempt Organizations

- Fringe benefits are often overlooked and are area of focus of IRS. Common reasons are
 - Difficulty in identifying
 - Difficulty in valuing
 - Uncertainty in reporting
 - Changes in tax laws

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Fringe Benefits for Exempt Organizations

“Fringe benefits are probably the most common area where the Internal Revenue Service is imposing intermediate sanctions against exempt organizations under tax code Section 4958..... If an organization does not treat fringe benefits to its chief executives as income, it will be considered an automatic excess benefit.”

-Peter Lorenzeeti, IRS Official

- Note: Intermediate sanctions apply to 501(c)(3) & 501(c)(4) organizations.

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Accountable Plans

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Accountable Plans

- If employer maintains accountable plan, all reimbursements for business expenses are excluded from employee's income
- Section 1.62(c)(1) requires
 - Business connection
 - Substantiation
 - Return of amounts paid in excess of expenses pursuant to rules in regulations

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Accountable Plans

- Business connection
 - Plan must provide reimbursements or advances only for business expenses that would otherwise qualify as trade or business expenses under section 162
 - Section 162 allows deductions for all ordinary & necessary expenses paid or incurred during taxable year in carrying on trade or business
 - IRS & courts look to whether or not expenditure secured business benefit when evaluated if expense is ordinary & necessary

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Accountable Plans

- Substantiation
 - Employees required to provide sufficient information to satisfy “business connection” of expenditure
 - 5 “W”s
 - What – amount
 - When – time, date, etc.
 - Where – business location, destination, etc.
 - Why – business purpose
 - Who – for entertainment expenses

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Accountable Plans

- Contemporaneous Recordkeeping
 - Not formally required but strongly suggested
 - Section 1.274-5T(c)(1) provides that written evidence has considerably more probative value than oral evidence alone & probative value of written evidence is greater the closer in time it relates to expenditure or use

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Exclusions

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Fringe Benefits

General Rule: If Internal Revenue Code does not specifically exclude benefit from income, then benefit is taxable income to employee.

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Fringe Benefit Exclusions

Specific Exclusion Provisions from IRC Sec. 132

1. No-additional-cost service
2. Qualified employee discounts
3. Working condition fringe
4. *De minimus* fringe
5. On-premises athletic facilities
6. Qualified transportation fringe
7. Qualified moving expense reimbursements
8. Qualified retirement planning services
9. Qualified military base realignment & closure fringe

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No Additional Cost Benefits

- Excludable from income [IRC Sec. 132(b)] if
 - Service is offered for sale to the employer's customers in ordinary course of business **&**
 - Employer does not incur significant additional costs in providing these services

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No Additional Cost Benefits

- Examples
 - Free telephone service provided to telephone company employees
 - Free hotel rooms provided to hotel employees
 - Furnishing of bus, cruise, airline, railroad, or subway transportation
 - Fitness/rehab centers used by employees for hospitals
 - Fitness/recreation centers used by employees for universities

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Employee Discounts

- Excluded from income [IRC Sec. 132(c)] if
 - Discounts are for qualified property or services (property or services offered for sale to customers in ordinary course of business)
- Limitations
 - Does not apply to real property, property ordinarily held for investment, or property or services not offered for sale to customers in ordinary line of business
 - Services—maximum discount is 20% of price employer offers to customers
 - Property—maximum discount is employer's gross profit percentage

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Employee Discounts

- Examples
 - Manufacturers who provide products to employees at cost
 - Medical doctors who reduce rates to employees for medical services
 - Employee discounts in hospital cafeteria
 - Employee discounts at university bookstore

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Working Condition Fringe Benefits

- Entire value of property or service excludable from employee's income [IRC Sec. 132(d)] if
 - Employee would be able to deduct it as trade or business expense if he had to pay for it (serve purpose of getting employee's job done)
- Does not preclude nonitemizers or take into account that such deductions may be limited to 2% of AGI threshold for miscellaneous itemized deductions

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Working Condition Fringe Benefits

- Examples
 - Subscriptions to business periodicals used by employee at work
 - Business use of car
 - Business meals
 - Cash reimbursements for business travel
 - Job training

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Working Condition Fringe Benefits

- Volunteers must meet following conditions to exclude these benefits
 - They must be performing service for either tax-exempt entity or governmental agency
 - The total value of fringe benefits they receive from organization must be substantially less than total value of services they provide to organization on volunteer basis

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De Minimis Benefits

- Excluded from employee's income [IRC Sec. 132(e)] when
 - Employer-provided property or services have such small value & frequency that accounting for them would be impractical
- *De Minimus* rules do not apply to
 - Cash & cash equivalents (including gift cards)
 - Membership in private country clubs or athletic facilities

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De Minimis Benefits

- Examples
 - Employee cocktail parties
 - Company picnics
 - Coffee & doughnuts
 - Occasional use of copy machine

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Fitness & Athletic Facilities

- Exclusion [IRC Sec. 132(j)(4)] applies to
 - Value of use or availability of gym or athletic facility that is **not open to public**
- Conditions
 - Facility is located on employer's premises
 - Facility is operated by the employer &
 - Substantially all use is by employees of employer (or employee's spouses & dependent children)

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Fitness & Athletic Facilities

- Nondiscrimination rules for facilities apply; exclusion denied if found to be primarily for benefit of highly compensated individuals
- Examples
 - Tennis courts
 - Gymnasiums
 - Pools
 - Golf courses

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Fitness & Athletic Facilities

- Benefit to university employees of using fitness centers for students excluded under no-additional-cost fringe benefit rule
 - Example
 - University A provides off-campus fitness memberships to employees—FMV of membership included as taxable income to employee
 - University B has on-campus fitness center operated by university for students—benefit excluded as no-additional-cost fringe benefit

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Fitness & Athletic Facilities

- Benefit to hospital employees of using fitness/rehabilitation centers excluded under no-additional-cost fringe benefit rule
 - Example
 - Hospital A provides free access to fitness center to employees during normal operating hours available to public/patients—benefit excluded as no-additional-cost fringe benefit
 - Hospital B provides free access to fitness center to employees during three hours every morning before center is open to public/patients—benefit included in income as taxable fringe benefit, would require additional cost to operate during this time for just employees

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Qualified Transportation Fringe Benefits

- Exclusion [IRC Sec. 132(f)] when
 - Employer provides one or more of following transportation benefits
 - Transit passes
 - Qualified parking
 - Certain transportation in commuter highway vehicle
 - Qualified bicycle commuting reimbursements

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Qualified Transportation Fringe Benefits

- Limitations
 - Exclusion calculated separately monthly & excess not used may not be carried over to another month
 - Maximum \$230/month for aggregate total of transit passes & commuter highway vehicles in 2010 & 2011
 - Maximum \$230/month for qualified parking in 2010 & 2011
 - Maximum \$20/month for bicycle commuting reimbursements if employee does not receive another transportation fringe benefit

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Qualified Moving Expense Reimbursement

- Reimbursements from employer excluded from income [IRC Sec. 132(g)] if
 - Reasonable expenses were paid or incurred in connection with the commencement of work as employee or as self-employed individual at new principal place of work
- Conditions
 - New place of work is at least 50 miles farther from former residence than former place of work (if no former place of work, at least 50 miles from former residence) &
 - Employee works full time at least 39 weeks in following 12-month period & 78 weeks in following 24-month period in that general location

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Qualified Moving Expense Reimbursement

- Reimbursements directly to employee reported on employee's Form W-2, Box 12 using Code P
- Examples
 - Expenses of moving household goods & personal effects from one residence to another
 - Expenses including lodging of moving from one residence to another
 - Includes payments made directly to third party & services furnished in kind

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Qualified Retirement Planning Services

- Exclusion [IRC Sec. 132(m)] includes
 - Information about employer's plan
 - Advice & information regarding retirement income planning for individual & how the employer's plan fits into individual's overall retirement plan

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Qualified Retirement Planning Services

- Limitations
 - Does not apply to general services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services
 - Does not apply to highly compensated employees unless service is available on substantially same terms as to all employees provided information regarding plan

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Military Base Realignment & Closure

- Exclusion [IRC Sec. 132(n)] refers to
 - One or more payments made under Homeowners Assistance Program (HAP) to offset adverse effects on housing values as result of military base realignment or closure

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Military Base Realignment & Closure

- Applies to
 - Federal civilian employees & members of Armed Forces who own or owned property near military base
 - Certain wounded Armed Forces members & wounded civilian Department of Defense & Coast Guard employees
 - Armed Forces members permanently reassigned from area at or near military installation to new duty station more than 50 miles away

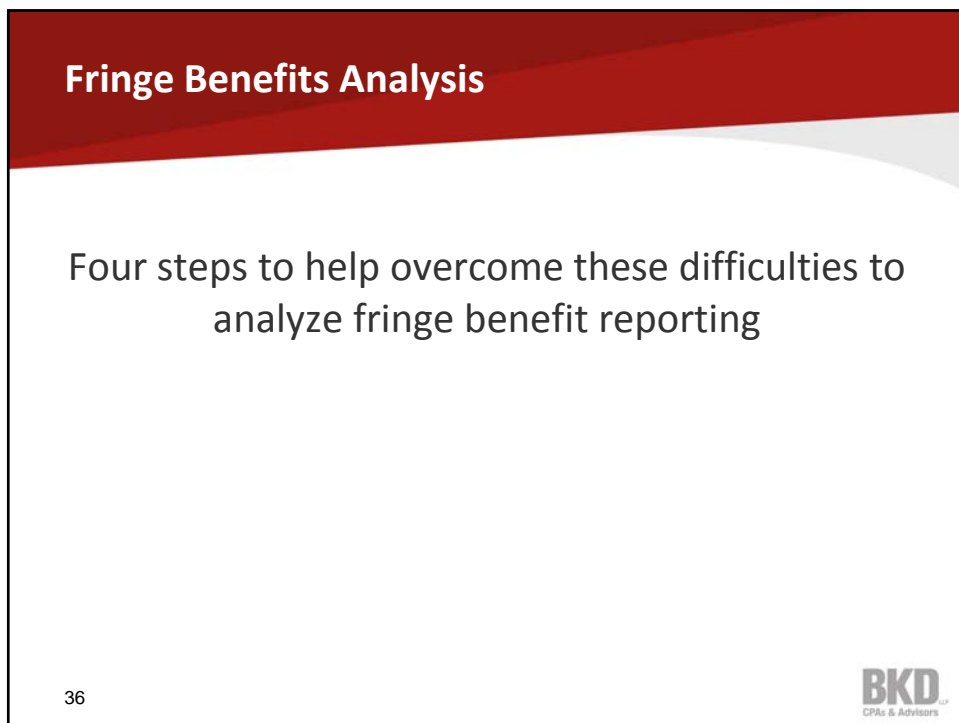
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Fringe Benefit Analysis


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Fringe Benefits Analysis

Four steps to help overcome these difficulties to analyze fringe benefit reporting

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Fringe Benefits Analysis

1. Identify particular fringe benefit and start with assumption that its value will be taxable as compensation to employee

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Fringe Benefits Analysis

2. Check to see if there are any statutory provisions that exclude fringe benefit from employee's gross income
 - Does particular benefit provided meet statutory definition of exclusion?
 - Will all "employees" meet definition of "employee" provided in exclusion?
 - Are there special rules to consider?
 - What is excluded?
 - Any limits to types of benefits or employees afforded exclusion?

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Fringe Benefits Analysis

3. Value any portion of benefit that is not excludable for inclusion in employee's gross income

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Fringe Benefits Analysis

4. Document decision & support for treatment of fringe benefit

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Common Fringe Benefits

- Accident & health benefits
- Gifts & awards
- Adoption assistance
- Dependent care assistance
- Educational assistance
- Group term life insurance coverage
- Lodging & meals on business premises
- Housing assistance & allowances*
- Payments for business use of personal residence*
- Professional dues, publications & meetings

*Schedule J disclosures required

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Common Fringe Benefits

- Companion travel*
- Employer provided auto use
- Travel & entertainment reimbursements
- Cell phone usage
- Discretionary spending accounts*
- Tax indemnification & gross up payments*
- Health or social club dues*
- Personal services*
- Outplacement services

*Schedule J disclosures required

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Accident & Health Benefits

- Payments to employees who are ill or injured [IRC Sec. 106)
- May take form of employer-provided insurance or direct reimbursement of medical expenses
- Nondiscrimination rules apply; exclusion denied if found to be in favor of highly compensated employees
- Example
 - Provision of major medical insurance to employees

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Gifts & Awards

- Employers may give employees cash or noncash awards & prizes as a reward for achievements within organization
- FMV of rewards are included in gross income of employee with some exceptions (IRC Sec. 74)
- **Cash gifts & awards are always included in gross income**
- Gift cards are cash equivalents and therefore always taxable to the employee.

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Gifts & Awards

- Gifts & awards may be excluded from income under certain exceptions
 - *De minimus* fringe benefits
 - Recognition awards transferred to charity
 - Tangible **noncash** employee achievement awards given for length of service or safety
 - Must be presented in meaningful presentation
 - FMV of award must be under \$400
 - Length of service may not be during first five years of employment
 - Traditional retirement awards presented upon completion of lengthy term of service

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Gifts & Awards

- *De minimus* examples
 - Turkeys given for Thanksgiving
 - Turkey provided to employee—nonfrequent with little value. Meets *de minimus* rules for exclusion
 - \$25 gift card to local grocery store provided to employee with intent of employee purchasing a turkey—cash equivalent, taxable to employee
 - Pin or other items or recognition with little value—meets *de minimus* exclusion rules

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Gifts & Awards

- Other Examples
 - Gold watch given to long-time employee
 - Given upon retirement after 20 years of service
 - ❖ Excluded as retirement award regardless of value
 - ❖ Award related to years of employment
 - ❖ Not compensatory
 - ❖ No expectation of future services
 - Given for completion of 20 years of service (not retiring)
 - ❖ Generally taxable to employee
 - ❖ Excluded if
 - FMV of award is less than \$400
 - Presented in meaningful presentation

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Adoption Assistance

- Exclusions from income (IRC Sec. 137) include
 - Amounts paid by employer to, or for, benefit of employees for qualified adoption assistance
 - Must be paid under written adoption assistance plan
 - Written plan must be in place before expenses incurred &
 - Notice of plan existence must be provided to employee before expenses are incurred
 - For 2010, maximum amount of reimbursement can not exceed \$12,170 per child. Phased out for taxpayers with AGI between \$182,520 & \$222,520

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Adoption Assistance

- Examples
 - Adoption fees
 - Court costs
 - Attorney fees
 - Travel expenses while away from home

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Dependent Care Assistance

- Exclusion from income [IRC Sec. 129(a)] for
 - Plan by which employer
 - Pays (or reimburses employee for payment to) third party for dependent care *or*
 - Provides dependent care facility for use of employees
- Must be pursuant to a dependent assistance program
 - Must be separate written plan
 - For exclusive benefit of employees
 - Benefits those qualifying under eligibility guidelines of employer

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Dependent Care Assistance

- Limitations
 - Maximum exclusion is \$5,000 per year (\$2,500 for married filing separately)
 - Cannot exceed employee's earned income or earned income of lower earning spouse for employee who is married
 - Reimbursements to employee's dependents, spouse or children under age 19 not excludable from income
- Examples
 - Daycare assistance
 - On-site child care

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Educational Assistance—Qualified EAPs

- Qualified Educational Assistance Programs (Qualified EAPs)
 - Exclusion from income [IRC Sec. 127(b)] for
 - Plan by which employer furnishes educational assistance to employee
 - Must be pursuant to employer educational assistance program
 - Must be separate written plan
 - For exclusive benefit of employees
 - Benefits those qualifying under eligibility guidelines of employer
 - There may not be alternative program available to employees & reasonable notification of program's availability & terms must be provided

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Educational Assistance—Qualified EAPs

- Limitations
 - Maximum exclusion is \$5,250 per calendar year
 - Cannot discriminate in favor of highly compensated employees
- Job-related & nonjob-related education may qualify
- To extent that benefits are not excluded under IRC Sec. 127, they may still be excluded as working condition fringe benefits if they would have been deductible by employee as business expense

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Educational Assistance—Qualified Tuition Reduction

- Qualified Tuition Reduction—for employees of higher educational institutions. Exclusion from income [IRC Sec. 117(d)]
 - Employee or employee's spouse or dependents
 - Below graduate level courses
 - May not discriminate in favor of highly compensated employees
 - Special exception—tuition reduction for graduate students that are teaching &/or research assistants is excludable from employee's taxable income

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Educational Assistance—Job-Related

- Job-related education assistance—payments or reimbursements for job-related educational expenses
- Exclusion from income as working condition fringe when
 - Expense would have been deductible by employee as job-related expense
 - Courses must relate to maintaining or improving the skills required for the job
 - The education must not lead to the employee qualifying for a new trade or job
- No dollar limits
- Professional education (CPE, CME, etc.)

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Educational Assistance

- Examples
 - Tuition
 - Fees
 - Books
 - Supplies & equipment

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Group Term Life Insurance Coverage

- Exclusion from income [IRC Sec. 79(a)] for
 - Employer-paid premiums for group term life insurance coverage
- Limitations
 - Coverage is less than \$50,000
 - Exclusion does not apply for employees in qualified employee trust or annuity plan
- Nondiscrimination rules apply; exclusion denied if found to be in favor of key employees

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Group Term Life Insurance Coverage

- Amounts paid for coverage exceeding \$50,000 are taxable to employee
 - IRS table is used to determine taxable portion to be included in employee's compensation
 - Exceptions (coverage exceeding \$50,000 not taxable)
 - Employee has terminated employment & is disabled
 - Employer is directly or indirectly beneficiary of the policy or charitable organization is beneficiary of policy
 - Cost of group term life insurance is provided under contract, owned by tax-qualified retirement trust or purchased as part of qualified annuity plan

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Lodging & Meals on Business Premises

- Exclusion from employee income [IRC Sec. 119(a)] for value of lodging & meals when
 - Provided for convenience of employer
 - Both lodging & meals are provided on business premises
 - Lodging—employee is required to accept such lodging as condition of employment
- Exclusion does not apply if there is option to accept additional compensation in lieu of meals & lodging

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Lodging & Meals on Business Premises

- Examples of qualified lodging on business premises
 - University president is required to live in a house on university campus
 - Private employer lodging in foreign country where housing is remote
 - Apartments owned by medical center & leased to residents & nurses for below market prices

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Lodging & Meals on Business Premises

- Examples of qualified meals on business premises
 - Meals provided after hours for employees working overtime
 - Meals provided during employer's training seminars
 - Hospital provision of free meal from cafeteria to substantially all employees during each work day so that employees may be on call at all times

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Housing Assistance & Allowances

- Housing Assistance
 - Employers may consider providing payments to employees to assist them in obtaining affordable housing. These payments are treated as taxable compensation in year paid
 - Examples
 - Down payments
 - Closing costs
 - Financing assistance

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Housing Assistance & Allowances

- Housing Allowances
 - Housing allowances are always taxable to the employee
 - Exempt organizations should periodically review amounts provided for reasonableness of total compensation paid
 - Special rule for ministers (IRC Sec. 107)
 - Housing allowances & fair rental value of church-owned parsonages provided to ministers are excluded from income
 - Ministers employed by university as faculty, managers, executives, or administrators also eligible for exclusion

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Payments for Business Use of Personal Residence

- Payments for business use of personal residence are generally taxable to employee unless paid or reimbursed under accountable plan
- Accountable plans are excluded from income as working-condition fringe benefits
- Accountable plan
 - Expenses must be reasonable business expenses
 - Employee must adequately account for expenses within reasonable time. Written evidence strongly suggested but not required
 - Employee must return any amount of excess reimbursement within reasonable time

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Payments for Business Use of Personal Residence

- Example
 - President of university uses his home for business meeting of university. Expenses reimbursed under accountable plan as excluded from president's taxable income

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Professional Dues, Publications & Meetings

- Employer costs excluded from income when connected with job employees perform
- Payments are excludable as working condition fringe benefits

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Professional Dues, Publications & Meetings

- Examples
 - Professional dues
 - Cost of attending professional meetings
 - Cost of attending training sessions
 - Cost of membership in professional organizations that are not social or entertainment-oriented organizations

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Companion Travel

- Employer-provided spouse or dependent travel is generally taxable income to employee
- Qualifies for exclusion as working condition fringe benefit only if employer
 - Can adequately demonstrate that spouse's, dependent's or other accompanying individual's presence on employee's business trip has bona fide business purpose &
 - If employee substantiates travel
 - If the companion is also an employee

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Employer-Provided Auto Use

- Use of employer-provided auto by employee in employer's business is an excludable working condition fringe [IRC Sec. 132, Reg. Sec. 1.132-5(b)]
- Personal use of company auto is taxable fringe benefit
- If vehicle is operated for business & personal use, excludable working condition fringe only includes business use portion

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Employer-Provided Auto Use

- Excludable working condition fringe is determined by allocating auto's value between employee's business & personal use
- Personal use cannot be changed to business use by attaching display material that advertises business while employee drives
- Business use must be properly substantiated with adequate records

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Travel & Entertainment Reimbursements

- Excluded from income as working condition fringe benefit
- Conditions
 - Travel & entertainment expenses business-related
 - Costs sufficiently documented
 - Reimbursements provided to employee pursuant to accountable plan

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Cell Phone Usage

- Employers may provide employees with cellular telephones or other similar telecommunications equipment
- Business use of cell phones are considered working condition fringe benefits & nontaxable
- FMV of employee's personal use is taxable compensation (see next slide)

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Cell Phone Usage

- For tax years after 2009, cells phones are no longer listed property, meaning
 - Employer no longer needs to meet substantiation requirements to deduct or depreciate equipment
 - Does not eliminate requirement to include personal use in employee taxable income

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Cell Phone Usage

- Additional IRS guidance recently issued:
 - For cell phones issued for non-compensatory purposes
 - Business Use = non-taxable working condition fringe benefit
 - Personal Use = non-taxable de minimus fringe benefit
 - For cell phone reimbursements
 - Still subject to accountable plan rules
 - Reimbursement can not exceed cost for service needed to perform job duties
 - ❖ No international calling features if international calling not required.

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Discretionary Spending Accounts

- Account or sum of money controlled by person who is not accountable to organization under accountable plan
- Payments included in compensation regardless of whether they are personal in nature

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Tax Indemnification & Gross Up Payments

- Payments or reimbursements of employee's tax obligations
- Taxable to employee & must be paid under accountable plan
- Example
 - Organization has policy that reimburses officers for the income taxes paid on nondeductible moving expenses or entertainment expense reimbursements—amount reimbursed is additional income to officer

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Health or Social Club Dues

- Membership dues are taxable to employee regardless of whether club is tax-exempt
- Includes dinner clubs/golf club memberships
- Examples of payment
 - Entrance fees
 - Periodic fees
 - Other amounts paid for using facilities
- Where exempt organization maintains membership for business purposes, any personal use is taxable to employee unless personal use reimbursed by employee or paid directly to club

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Personal Services

- Included as taxable compensation to the employee
- Payments or reimbursements for services must be made under accountable plan
- Does not include services organization provides to all employees on nondiscriminatory basis under qualified employee benefit plan

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Personal Services

- Examples
 - Maid
 - Chauffeur
 - Chef
 - Personal trainer
 - Babysitter
 - Tax services
 - Housekeeping
 - Yard maintenance

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Outplacement Services

- Outplacement services are programs designed to assist employee in finding other suitable employment
- Employer may provide employees with outplacement services in connection with termination of employment as working condition fringe benefit (Rev. Rul. 92-69)

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Outplacement Services

- Services include
 - Career counseling
 - Seminars on resume preparation
 - Seminars on interviewing skills
 - Use of copiers & telephones in conducting job search

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Questions?

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